INTERNATIONAL JOURNAL OF eBUSINESS AND eGOVERNMENT STUDIES
Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209
Received: 15.04.2026 | **Accepted:** 20.05.2026 | **Published Online:** 30.06.2026

-RESEARCH ARTICLE-

THE IMPACT OF TEMPORARY DIFFERENCES BETWEEN ACCOUNTING INCOME AND TAXABLE INCOME ON EARNINGS QUALITY IN INDUSTRIAL COMPANIES

Arshed Makki Rashid

Department of Accounting, College of Management and Economics, University of Al Qadisiyah, Iraq
ORCID: https://orcid.org/0009-0009-0469-1404
Email: arshed.makki20@qu.edu.iq

Ahmad Mahdy Hady

Department of Accounting, College of Management and Economics, University of Al Qadisiyah, Iraq
ORCID: https://orcid.org/0000-0002-2583-2757
Email: ahmad.mahdy@qu.edu.iq

─Abstract─

The divergence between accounting and taxation frameworks gives rise to differences in reported and taxable income, with temporary discrepancies subsequently reversing through deferred tax balances. However, the informational significance of these differences for earnings quality remains unresolved, as substantial temporary differences may reflect either managerial discretion in accrual recognition or legitimate underlying business transactions. Against this background, the study develops and evaluates two empirical specifications for industrial companies. Model 1 examines the association between earnings quality, measured through earnings persistence, and temporary book-tax differences normalised by total assets, while incorporating firm size, leverage, profitability and operating cash flow as control variables. Model 2 extends this framework by introducing a mediating mechanism within a structural model. Both specifications indicate an inverse relationship, although their estimated effects differ. The regression produces a coefficient of −0.318s ($p = .001$), whereas the standardised direct effect reaches −0.428 ($p < .001$), with the indirect pathway accounting for 30.41% of the overall effect. Because these estimates originate from simulated data intended solely to demonstrate the methodology, the study does not seek

Citation (APA): Rashid, A. M. Hady, A. M. (2026). The Impact of Temporary Differences Between Accounting Income and Taxable Income on Earnings Quality in Industrial Companies. *International Journal of eBusiness and eGovernment Studies, 18*(2), 221-246. doi:10.34109/ijebeg.2026180209

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

to establish population-level conclusions. Instead, its principal contribution concerns the comparative interpretation of the two modelling approaches, particularly how their specifications influence the relationships identified. Accordingly, the paper elaborates the estimation procedures, identifies the circumstances in which the models yield divergent outcomes, and establishes the empirical evidence necessary for their subsequent validation.

Keywords: Temporary Differences; Accounting Income; Taxable Income; Book-Tax Differences; Earnings Quality; Deferred Tax; Industrial Companies

JEL Classification: M41; H25; G30

INTRODUCTION

Reported earnings constitute a principal source of financial information, although their decision-making relevance depends more fundamentally on their capacity to represent sustainable performance than on their absolute magnitude. Earnings quality reflects this distinction by indicating whether current reported results provide meaningful insights into future cash flows. Consequently, the reliability of earnings as an indicator of subsequent performance is important to investors, lenders, auditors and other financial statement users. Although the determinants of market valuation have evolved and the methodological approaches used to assess earnings quality have become increasingly diverse, the fundamental concern regarding the informational usefulness of reported earnings remains unchanged (Oh & Penman, 2024; Theodore E. Christensen, 2021).

The distinction between accounting income and taxable income originates from the different objectives and regulatory principles governing their calculation. Financial reporting standards are designed to represent an entity's economic activities, whereas taxation legislation establishes the income base upon which tax obligations are determined and collected. Differences in recognition criteria and measurement procedures consequently produce book-tax differences (BTDs), conventionally classified as permanent or temporary. Permanent differences arise when an item affects only one income measure without subsequent reversal. Conversely, temporary book-tax differences (TBTDs) reflect discrepancies in the timing of recognition, whereby revenues, expenses, assets or liabilities are accounted for in different periods for financial reporting and taxation purposes. As the associated assets are recovered or liabilities discharged, these differences reverse and are reflected through deferred tax assets (DTAs) and deferred tax liabilities (DTLs). The expanding empirical evidence concerning these balances has subsequently become sufficiently extensive to warrant systematic examination (Anna Görlitz, 2023).

The potential relevance of TBTDs to earnings quality arises from the different degrees of managerial judgement permitted under the two measurement frameworks. Although

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

accounting and taxable income originate from identical underlying transactions, financial reporting allows accrual-based discretion that can facilitate earnings management. Accordingly, discrepancies between these measures may provide an incomplete yet informative indication of the extent to which reported profitability depends on discretionary accruals rather than realised economic transactions. Empirical findings support this interpretation, demonstrating an adverse relationship between TBTDs and earnings quality among listed manufacturing companies (Widiatmoko et al., 2023). Further evidence indicates that tax-related differences remain associated with earnings persistence and its constituent accrual and cash-flow elements (Pereira et al., 2023). Research examining book-tax conformity similarly identifies both the informational possibilities and interpretive limitations of these discrepancies (Floropoulos et al., 2024).

Statement of the Problem

The central challenge in interpreting substantial TBTDs is that fundamentally different economic and reporting circumstances may generate observationally similar outcomes. One explanation attributes these discrepancies to managerial discretion, whereby revenues are recognised prematurely, or expenses are deferred under accounting treatments that are not permitted for taxation, potentially exaggerating the sustainability of reported profitability. An alternative explanation relates to genuine economic developments. Asset impairments, corporate restructuring, operational closures and pronounced reductions in sales can create considerable differences between accounting and taxable income without necessarily indicating opportunistic reporting. Distinguishing these explanations is difficult using the observed discrepancy alone. Recent research demonstrates that the relationship between BTDs and earnings persistence varies with the economic circumstances surrounding their emergence (Anderson & Rahiminejad, 2025). Complementary evidence concerning impairment-related big-bath accounting further illustrates how recognition decisions interact with deteriorating operating conditions (Tselinko, 2023).

An additional methodological concern involves the specification through which the relationship is estimated. One approach treats TBTDs as directly associated with earnings quality, without explicitly modelling intervening mechanisms. An alternative incorporates an organisational condition through which part of the relationship is transmitted. These specifications are not nested and can produce different estimates for the direct relationship, yet existing empirical investigations have predominantly employed the former without systematically comparing its implications with those of a mediated framework. Evidence from governance and internal-control research provides a rationale for considering intermediary mechanisms. Specifically, internal control quality influences conditional conservatism (Mounia Boulhaga, 2023), the effectiveness of internal audit functions is associated with earnings quality (Dorcus Kalembe, 2024),

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

and corporate governance arrangements shape the relationship between taxation strategies and financial reporting outcomes (Kovermann & Velte, 2019).

Accordingly, the present investigation addresses two interconnected problems. The first concerns whether variations in the existence and magnitude of TBTDs correspond to differences in earnings quality across industrial companies. The second examines whether a conventional single-equation model sufficiently represents this association or whether an explicit mediated structure provides a different interpretation. The overarching research question is therefore: to what extent do TBTDs influence earnings quality among industrial companies, and what proportion of the overall effect operates indirectly rather than through a direct relationship?

Significance of the Study

The importance of this investigation derives from the role of earnings quality in financial evaluation and resource-allocation decisions. Investors, financial analysts, creditors and regulatory authorities routinely rely on reported earnings when assessing corporate performance. Nevertheless, the amount of income disclosed does not independently establish its capacity to persist. Financial statement indicators that provide evidence about the sustainability of earnings can therefore improve interpretation without requiring confidential organisational information.

TBTDs offer a potentially useful indicator because they are measurable, publicly disclosed and subject to audit procedures. Unlike discretionary accrual estimates, which depend on researcher-specified models, these differences originate from established accounting and taxation calculations and are reflected in deferred tax disclosures. This distinction is relevant because the reliability of accrual-based earnings management measures remains disputed. Existing research demonstrates that such measures may incorrectly classify economically justified managerial decisions as opportunistic reporting practices (Theodore E. Christensen, 2021). Consequently, the mechanically determined nature of disclosed tax differences provides a practical advantage, notwithstanding their potential limitations as indicators of earnings quality.

The selection of industrial companies reflects the characteristics of their operating and financial reporting environments. Industrial activities typically involve substantial investments in property, plant and equipment, alongside depreciation, inventory valuation, provisions and asset impairment. These items frequently receive different treatment under financial reporting standards and taxation legislation, producing relatively substantial and variable TBTDs. The industrial sector consequently provides a setting in which the proposed relationship may be particularly observable. Furthermore, manufacturing and industrial financial performance has received considerable attention in the existing research literature (Agnus Baby, 2024). From a practical perspective, the investigation may clarify the informational relevance of

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

deferred tax disclosures. Should TBTDs provide incremental evidence concerning earnings quality, the deferred tax note would serve an analytical function beyond regulatory compliance, warranting greater consideration by auditors, investors and supervisory authorities. Conversely, where a substantial proportion of the association operates through organisational conditions, the usefulness of these disclosures would depend partly on those conditions. Interpretation would therefore require consideration of governance quality alongside the reported tax balances rather than treating the disclosures as independently sufficient.

The institutional environment introduces a further dimension to the study's significance. The informational content of BTDs depends partly on the extent to which accounting and taxation regulations permit different recognition and measurement outcomes. Under strong book-tax conformity, differences are restricted by regulatory design, limiting their potential signalling capacity. Under weaker conformity, greater divergence may provide more information, although it simultaneously increases the possibility that observed discrepancies arise from legitimate differences between accounting and taxation objectives. Evidence linking national taxation characteristics to variations in earnings management supports the relevance of this institutional distinction (Simon Helms, 2025). Consequently, relationships estimated within one regulatory jurisdiction cannot automatically be generalised elsewhere. The present investigation therefore considers industrial companies without if its estimated parameters possess cross-jurisdictional validity.

Research Objectives

The study seeks to examine how TBTDs relate to earnings quality in industrial companies through the following objectives:

- To establish operational measures of TBTDs and earnings quality for industrial companies and examine their distributions and bivariate relationships.
- To quantify the direct association between TBTDs and earnings quality using a single-equation model incorporating firm size, leverage, profitability and operating cash flow as control variables.
- To estimate the relationship within a structural framework incorporating an indirect pathway and evaluate its three constituent relationships.
- To determine the statistical significance of the indirect effect and identify the corresponding mediation classification.
- To distinguish the direct and indirect contributions to the total effect, calculate the proportion transmitted through mediation, and evaluate the structural model's explanatory capacity and goodness of fit.

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

- To compare the implications of the two modelling specifications and identify the empirical requirements necessary for drawing defensible conclusions about industrial companies.

SCOPE AND STRUCTURE

Three principal boundaries define the investigation. First, the analysis concentrates exclusively on TBTDs, excluding permanent differences and the overall BTD measure. Second, earnings quality is operationalised through earnings persistence rather than the wider range of available quality indicators. Third, consistent with the original research specification, all reported numerical outcomes are generated through simulation for methodological demonstration. The study therefore contributes primarily through model development and comparative interpretation rather than statistical inference concerning an actual population of industrial companies. Section 6.4 identifies the conditions and evidence necessary for subsequent empirical implementation.

The organisation of the remaining sections follows the analytical progression of the investigation. Section 2 examines the literature concerning accounting and taxable income, TBTDs, deferred taxation, earnings quality and their interrelationships before formulating the research hypotheses. Section 3 describes the model specifications, variable definitions and estimation methodology. Section 4 presents the results obtained from both approaches, while Section 5 evaluates their implications. Section 6 provides the concluding discussion. The literature review is organised around five related themes. It first examines the regulatory origins of discrepancies between accounting and taxable income, followed by the characteristics of TBTDs and their representation through deferred tax balances. It subsequently considers the conceptualisation and measurement of earnings quality before assessing empirical findings concerning its relationship with TBTDs. These discussions provide the foundation for the proposed hypotheses.

Accounting Income and Taxable Income

Accounting income represents the financial performance recognised under the accounting standards applicable to a company, whereas taxable income denotes the amount calculated in accordance with taxation legislation for determining tax obligations. Although both measures originate from the same economic transactions, they differ because their respective regulatory frameworks impose distinct recognition, valuation and timing requirements. Financial reporting prioritises the faithful representation of economic performance, permitting estimates and professional judgement where necessary. Taxation systems instead emphasise the determination of an administratively verifiable and enforceable tax base, generally imposing greater restrictions on discretionary assessment.

Vol: 18 No: 2 Year: 2026 ISSN: 2146-0744 (Online) (pp. 221-246) Doi: 10.34109/ijebeg.2026180209

The extent of alignment between these frameworks reflects an institutional policy choice. Strong book-tax conformity limits divergence and effectively transfers certain restrictions embedded in taxation rules into financial reporting. Conversely, weaker conformity permits greater separation between the measures, potentially increasing the informational relevance of the resulting differences. Empirical research demonstrates that conformity influences corporate information environments, including the forecasting behaviour of financial analysts (Audrey Hsu, 2023). Similarly, differences in national taxation arrangements help explain international variation in earnings management practices (Simon Helms, 2025). Research addressing book-tax conformity therefore increasingly regards the interaction between the two income measures as a substantive analytical concern rather than an incidental accounting discrepancy (Floropoulos et al., 2024).

Importantly, taxation influences corporate behaviour through mechanisms extending beyond financial reporting. Existing reviews document its effects on investment choices, financing arrangements and organisational structures (Jacob, 2022), while firm-level investigations identify associations between taxation burdens, financial performance and risk exposure (Rompotis, 2024). These findings suggest that BTDs cannot be interpreted exclusively as reporting phenomena. Some portion may reflect genuine economic differences arising from how organisations structure and undertake activities subject to different taxation treatments.

Temporary Differences

TBTDs emerge when the recognised carrying value of an asset or liability differs from its corresponding tax base, with the discrepancy expected to reverse in subsequent periods. Depreciation provides a representative illustration. Where financial reporting and taxation apply different depreciation rates, the accounting carrying amount and tax base follow different trajectories during an asset's useful life before ultimately reconciling upon disposal. Comparable timing discrepancies arise from provisions, impairment charges, revenue recognition and the taxation deductibility of accrued expenses. Permanent differences are distinguishable because their effects do not reverse and therefore do not represent differences in recognition timing.

This classification is important when evaluating earnings quality because the temporary element directly concerns the period to which recognised income is attributed. For example, where accounting income exceeds taxable income because an item benefits from a permanent taxation exemption, the difference does not necessarily imply reduced earnings persistence. By contrast, recognising revenue for accounting purposes before its taxable recognition point creates a timing discrepancy involving income recognised in advance of its subsequent taxation. Accordingly, research examining earnings quality distinguishes TBTDs from permanent differences rather than treating the aggregate discrepancy as a homogeneous measure (Widiatmoko et al., 2023).

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

Nevertheless, the interpretive limitation identified in Section 1.1 remains particularly relevant. Substantial TBTDs may result from discretionary accrual choices, but they may equally arise from deteriorating operations, falling revenues or asset write-downs. Evidence demonstrating that declining sales moderate the association between BTDs and earnings persistence reinforces the importance of these underlying circumstances (Anderson & Rahiminejad, 2025). Related findings indicate that impairment recognition frequently coincides with periods already characterised by weak financial performance (Tselinko, 2023). Consequently, the magnitude of TBTDs cannot independently establish reporting quality; meaningful interpretation requires identification of the economic or accounting circumstances responsible for their emergence.

Deferred Tax and the Reporting of Temporary Differences

The financial reporting consequences of TBTDs are reflected through DTAs and DTLs. Deductible temporary differences generate DTAs, subject to the expectation that sufficient future taxable profits will be available to support their recognition. Taxable temporary differences, conversely, result in DTLs. These balances allocate the future taxation consequences of recognised transactions to the periods in which the corresponding assets are recovered or liabilities settled, thereby extending accrual accounting principles to taxation.

A systematic assessment of deferred taxation research indicates that empirical investigations have concentrated primarily on the valuation relevance of deferred tax balances and the discretionary opportunities associated with their recognition. Comparatively limited attention has been directed towards the informational properties of the underlying TBTDs (Anna Görlitz, 2023). Recognition decisions involving managerial judgement may themselves convey information. For instance, evidence concerning deferred tax valuation allowances suggests that such assessments communicate management's privately held expectations (Allen, 2025). Moreover, research has identified unintended consequences arising from the accounting requirements governing deferred tax recognition (Jude Edeigba, 2023). Accordingly, reported balances reflect not only underlying economic transactions but also the regulatory framework through which those transactions are measured (Seher et al. 2025).

Deferred taxation additionally connects financial reporting practices with corporate taxation strategies. Although tax avoidance may reduce taxation expenses, it also introduces uncertainty (Dyreng et al., 2019). Research examining corporate governance and tax avoidance has identified sufficiently consistent relationships to justify dedicated systematic evaluation (Kovermann & Velte, 2019). Regulatory enforcement further influences this environment, with stronger taxation oversight associated with reduced

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

corporate financial irregularities (Feng et al., 2023). The effectiveness of corporate tax management also depends on the quality of internal information systems (Saragih et al., 2024). Consequently, deferred tax disclosures emerge from the combined influence of financial reporting incentives, taxation objectives and organisational information capabilities.

Earnings Quality: Concept and Measurement

The meaning of earnings quality depends on the informational purpose for which reported earnings are evaluated. From a forecasting perspective, earnings are considered high quality when they provide reliable indications of future cash flows. From a stewardship perspective, quality instead emphasises the absence of opportunistic earnings management. This conceptual diversity has produced multiple measurement approaches, including persistence, predictability, accrual quality, earnings smoothness and value relevance. Each reflects a distinct attribute, meaning that different indicators may generate inconsistent assessments of the same firm's reporting quality.

The present study adopts earnings persistence, defined as the degree to which current earnings continue into subsequent reporting periods. This measure is particularly relevant to forecasting because it directly addresses the sustainability of reported performance. Recent examinations of the interaction between accruals and cash-flow components have refined understanding of both the informational contribution and limitations of persistence-based assessment (Oh & Penman, 2024). The relative forecasting usefulness of earnings and cash flows also remains an important empirical question, with evidence favouring earnings when their predictive performance is evaluated using consistent specifications (Ball & Nikolaev, 2022). Thus, although persistence provides a theoretically defensible indicator of earnings quality, it represents one dimension rather than a comprehensive measure, and its selection influences the resulting interpretation. Discretionary accrual-based indicators offer an alternative measurement approach but introduce methodological concerns. Estimation models designed to identify earnings management may incorrectly interpret legitimate operating decisions as manipulation at meaningful frequencies (Theodore E. Christensen, 2021). Comparative investigations further demonstrate that conclusions regarding earnings management can vary materially according to the detection model employed (Viana et al., 2023). Evidence associating greater financial statement comparability with lower financial reporting fraud also suggests that broader reporting-environment characteristics may provide valuable information beyond firm-specific discretionary accrual estimates (Belen Blanco, 2023).

Organisational monitoring represents another important determinant of earnings quality. Research identifies relationships between audit characteristics and earnings quality among listed companies (Chaudhary, 2024), while the contribution of internal audit function quality depends partly on the authority exercised by the chief executive

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

(Dorcus Kalembe, 2024). Governance arrangements and financial reporting reforms in emerging economies have also been associated with simultaneous changes in earnings quality and other reporting outcomes (Ines Kateb, 2024). Furthermore, internal control quality directly influences conservative recognition practices (Mounia Boulhaga, 2023). Collectively, these findings provide the conceptual justification for examining mediation, as they indicate that organisational conditions may intervene between financial reporting incentives and the resulting earnings outcomes.

Industrial Companies as a Setting

Industrial companies provide a particularly relevant environment for examining the proposed relationship because their operational characteristics intensify the mechanisms responsible for generating TBTDs. Capital-intensive production requires substantial investment in property, plant and equipment, for which financial reporting and taxation frequently prescribe different depreciation schedules. Industrial firms also maintain considerable inventories subject to distinct valuation requirements across the two regulatory frameworks. Similarly, warranty obligations, restructuring provisions and environmental liabilities may be recognised when the corresponding obligations arise for accounting purposes but become deductible only upon payment for taxation purposes. Asset impairment introduces further timing discrepancies, as financial reporting may require recognition following evidence of deterioration, whereas taxation rules in many jurisdictions defer recognition until disposal. Together, these characteristics mechanically generate TBTDs and can produce deferred tax balances that are materially greater than those observed in comparably sized service-sector or financial companies.

However, the same operational characteristics that increase the potential informational relevance of TBTDs also complicate their interpretation. Industrial companies experiencing adverse demand conditions may simultaneously recognise inventory write-downs and impairment losses on productive assets. Such adjustments can generate substantial timing discrepancies even when management has not exercised opportunistic reporting discretion. Empirical evidence indicates that impairment recognition is frequently concentrated in periods of already deteriorating performance (Tselinko, 2023). Furthermore, the documented moderating influence of declining sales on the association between BTDs and earnings persistence demonstrates that discrepancies arising during economic contraction may behave differently from those generated under stable operating conditions (Anderson & Rahiminejad, 2025).

Consequently, the industrial environment potentially amplifies both the informational signal and the economic noise embedded in TBTDs, requiring corresponding caution when interpreting empirical relationships. Research addressing manufacturing-sector financial performance has generally evolved independently of investigations

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

concerning BTDs, employing its own analytical indicators and control structures (Agnus Baby, 2024). Nevertheless, firm size, leverage, profitability and operating cash flow are commonly incorporated into both research traditions. Their inclusion in the present specification therefore supports comparability with findings derived from either literature.

Temporary Differences and Earnings Quality

Existing empirical research generally identifies a negative relationship between TBTDs and earnings quality, although the estimated magnitude tends to be relatively modest. Evidence from listed manufacturing companies indicates that larger TBTDs are associated with diminished earnings quality, a relationship interpreted in terms of the discretionary accrual practices partially reflected in the discrepancy (Widiatmoko et al., 2023). Investigations distinguishing deductible from taxable temporary differences further demonstrate that tax-related discrepancies retain informational relevance for earnings persistence and its underlying accrual and cash-flow components (Pereira et al., 2023). Beyond persistence, associations between BTDs, corporate payout decisions and firm valuation suggest that financial market participants regard these differences as economically informative (Dyussembina & Park, 2024).

Nevertheless, two important qualifications constrain the interpretation of these findings. First, the informational implications of TBTDs depend on the economic events and circumstances responsible for their formation. The documented conditional relationship between BTDs and earnings persistence illustrates this attribution problem (Anderson & Rahiminejad, 2025). Second, institutional characteristics influence the extent to which the observed association can be generalised. Jurisdictions differ in their degree of book-tax conformity, taxation enforcement and financial reporting quality, each of which may alter the relationship between TBTDs and earnings quality (Simon Helms, 2025). Evidence from emerging economies, including investigations modelling financial stability among Iraqi companies, further suggests that reporting relationships identified in developed institutional environments may not remain unchanged across different regulatory settings (Ibrahim et al., 2024).

HYPOTHESIS DEVELOPMENT

The preceding theoretical arguments and empirical findings support the formulation of three hypotheses. The first addresses the direct relationship between TBTDs and earnings quality, which is examined under both model specifications. When reported profitability incorporates accrual-based income recognition that is not accepted under taxation rules, a proportion of current earnings may lack the capacity to persist in subsequent periods. Consequently, greater reliance on such recognition practices is expected to weaken earnings persistence.

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

H1: *Temporary book-tax differences have a negative effect on earnings quality.*

The second and third hypotheses establish the mediated relationship incorporated into Model 2. This specification assumes that persistent discrepancies between financial reporting and taxation measures are associated with deterioration in the organisational conditions responsible for ensuring reliable recognition practices, which subsequently influence earnings quality. The proposed initial relationship is supported by empirical evidence demonstrating an association between corporate tax positioning and governance quality (Kovermann & Velte, 2019). The subsequent relationship is consistent with findings indicating that stronger organisational monitoring and internal control mechanisms contribute positively to earnings quality (Dorcus Kalembe, 2024; Mounia Boulhaga, 2023).

H2: *Temporary book-tax differences have a negative effect on the mediating variable.*
H3: *The mediating variable has a positive effect on earnings quality.*

Considered jointly, H2 and H3 suggest that TBTDs exert a negative indirect influence on earnings quality through the proposed mediating mechanism. Whether this indirect pathway substitutes for or operates alongside the direct relationship specified in H1 requires empirical verification. Establishing the nature of this relationship is essential for determining whether the single-equation framework employed in Model 1 adequately captures the underlying association.

Research Design

A quantitative research framework is employed to examine financial statement information relating to industrial companies. The investigation develops two independently estimated specifications, each addressing a distinct analytical objective rather than functioning as mutually exclusive alternatives. Model 1 evaluates the extent to which TBTDs explain variations in earnings quality after accounting for firm-specific characteristics. Model 2 extends the analysis by determining the proportion of the observed relationship attributable to an intervening mechanism. The resulting estimates are presented comparatively in Section 4, with their methodological and substantive implications examined in Section 5.1. Consistent with the original research specification, the numerical results presented in Section 4 are generated through simulation exclusively for methodological illustration. Nevertheless, the research design is comprehensively specified to facilitate its subsequent implementation using observed financial data. The empirical requirements for such an application are detailed in Section 6.4.

Vol: 18 No: 2 Year: 2026 ISSN: 2146-0744 (Online) (pp. 221-246) Doi: 10.34109/ijebeg.2026180209

Variables and Operationalisation

The analysis identifies TBTD as the independent variable, operationalised by dividing temporary differences by total assets. This normalisation minimises the mechanical influence of firm size and facilitates meaningful comparisons across companies. Earnings quality (EQ) constitutes the dependent variable and is assessed using earnings persistence as its empirical proxy. Four firm-level characteristics are incorporated as control variables: firm size (SIZE), calculated as the natural logarithm of total assets; leverage (LEV), expressed as the ratio of total liabilities to total assets; return on assets (ROA), representing net income divided by total assets; and operating cash flow (OCF), normalised by total assets. Table 1 summarises the selected variables and their hypothesised directional relationships, whereas Table 2 presents their measurement procedures and descriptive statistical characteristics.

Table 1: Research Variables and Predicted Signs

Variable	Symbol	Role in the Model	Predicted Sign
Temporary Book-Tax Differences	TBTD	Independent	Negative
Earnings Quality	EQ	Dependent	—
Firm Size	SIZE	Control	Positive
Leverage	LEV	Control	Negative
Profitability	ROA	Control	Positive
Operating Cash Flow	OCF	Control	Positive
Mediating Variable	MED	Mediator (Model 2 only)	Negative

Model 2 further incorporates a mediating construct, consistently designated as MED. Although this variable is integral to the structural estimates, the original research specification provides neither an explicit conceptual definition nor an operational measurement procedure. References to governance and transparency mechanisms in Section 5.2 of the original discussion nevertheless suggest the intended conceptual domain. Accordingly, MED is included in Table 1 to maintain completeness, while its undefined operational status is explicitly acknowledged as a methodological limitation in Section 6.4 rather than being left unaddressed.

Table 2: Operationalisation of the Study Variables and Descriptive Statistics

Variable	Measurement	*M*	*SD*
TBTD	Temporary differences / total assets	0.018	0.032
EQ	Earnings persistence	0.576	0.143
SIZE	Natural logarithm of total assets	13.542	1.284
LEV	Total liabilities / total assets	0.421	0.187
ROA	Net income / total assets	0.067	0.058
OCF	Operating cash flow / total assets	0.074	0.081

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

The descriptive statistics provide an overview of the variables' distributions and magnitudes. TBTDs exhibit a mean equivalent to 1.8% of total assets and a standard deviation of 3.2 percentage points, indicating a right-skewed distribution and a relatively small magnitude compared with the underlying asset base. The average earnings persistence coefficient is .576, consistent with values commonly documented among listed companies. Meanwhile, mean LEV and ROA stand at 42.1% and 6.7%, respectively, reflecting levels generally observed within the industrial sector.

Model Specification

Model 1 is specified and estimated using ordinary least squares (OLS) regression as follows:

$$EQ_{i,t+1} = \beta_0 + \beta_1 TBTD_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 ROA_{i,t} + \beta_5 OCF_{i,t} + \varepsilon_{i,t}$$

The dependent variable is specified with a one-period lead, enabling the relationship between current-period TBTD and subsequent-period earnings to be examined. Model 2 extends the single-equation framework into a structural system incorporating three relationships: TBTD → MED, MED → EQ, and the direct pathway TBTD → EQ, while retaining the four control variables. Figure 1 illustrates both model specifications within a unified diagram, with dashed lines distinguishing the additional pathways introduced in Model 2.

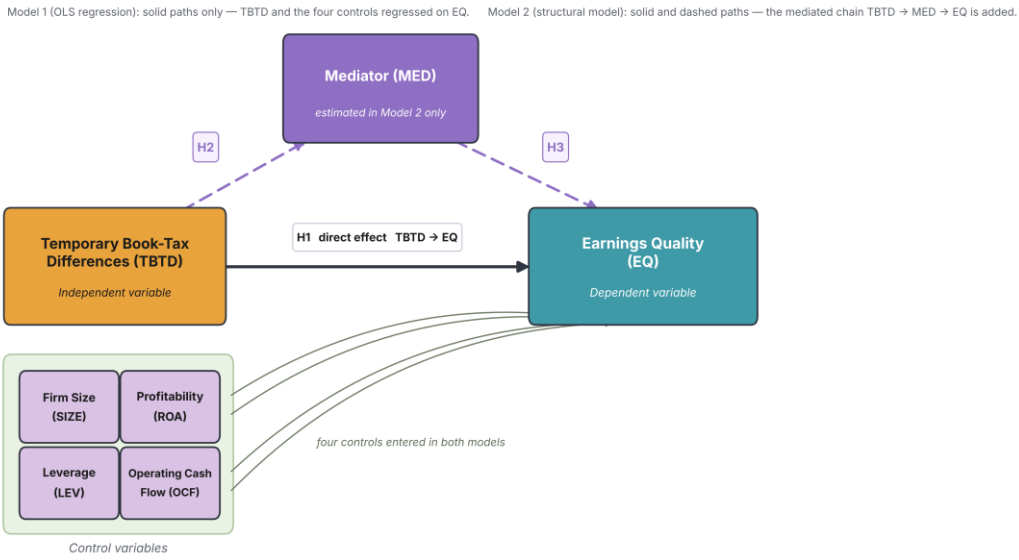

Figure 1: Conceptual Framework for Model 1 and Model 2
Note: Solid paths are common to both models; dashed paths are estimated in Model 2 only. TBTD = Temporary Book-Tax Differences; MED = Mediating Variable; EQ = Earnings Quality

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

Introducing a one-period lead for the dependent variable is consistent with the conceptualisation of earnings quality through earnings persistence. This specification examines whether earnings recognised in the current period remain informative about subsequent earnings and whether contemporaneously recognised TBTDs predict the extent of that persistence. Compared with a contemporaneous specification, this temporal arrangement provides a stronger analytical framework by reducing the possibility that the observed association arises mechanically from both variables being derived from the same period's accruals. Nevertheless, it cannot eliminate the influence of persistent firm-specific characteristics that may jointly determine both variables. This remaining identification concern is addressed in Section 6.4.

Estimation and Diagnostics

The empirical procedure comprises four sequential stages. Initially, descriptive statistical analysis establishes the distributional characteristics of the study variables. Pearson correlation analysis subsequently evaluates their pairwise relationships while providing preliminary evidence concerning potential multicollinearity. Model 1 is then estimated using OLS regression, followed by structural estimation of Model 2. The statistical significance of the mediated effect is evaluated through bias-corrected bootstrapping involving 5,000 resamples, supplemented by the Sobel test.

Potential multicollinearity is examined using the correlation matrix and variance inflation factor (VIF). Rather than treating VIF as a rigid criterion for model acceptance, the analysis employs it as a descriptive indicator of collinearity. This approach reflects methodological evidence questioning the statistical justification for commonly applied VIF thresholds (Kalnins & Praitis Hill, 2025). Accordingly, diagnostic interpretation prioritises the stability and reliability of the estimated coefficients over compliance with an arbitrarily specified cut-off. Two methodological considerations are particularly relevant to the estimation framework. First, the temporal separation between the one-period-ahead dependent variable and contemporaneous explanatory variables mitigates straightforward simultaneity concerns but does not establish that the estimated relationship is independent of unobserved common determinants.

Existing methodological research demonstrates that alternative panel estimation approaches can yield materially different results when attempting to distinguish such influences (Leszczensky & Wolbring, 2022). Second, Model 2 incorporates covariance-structure goodness-of-fit indicators, whose interpretation depends on estimation from a covariance matrix involving multiple indicators. The methodological distinction between covariance-based and variance-based structural estimation therefore determines which fit statistics can be meaningfully interpreted (Dash & Paul, 2021). Both limitations receive further consideration in Section 6.4. The presentation of findings follows four components: bivariate relationships, Model 1 estimates, Model 2

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

estimates, and the structural model's goodness of fit and explanatory performance. All numerical results are retained exactly as reported in the original estimation output, without modification.

CORRELATIONS

The correlation results presented in Table 3 indicate an inverse association between TBTD and EQ (−.286, p < .01), consistent with the directional expectation established in H1. EQ exhibits positive correlations with SIZE (.241), ROA (.327) and OCF (.294), whereas its relationship with LEV is negative (−.198). All four associations are statistically significant at the 1% level and conform to their hypothesised directions. Regarding the relationships between TBTD and the control variables, positive coefficients are observed for SIZE (.174) and LEV (.219), while ROA (−.163) and OCF (−.142) display negative associations. The relationship involving OCF is the only statistically insignificant correlation reported in the matrix. The strongest correlation between distinct variables is observed for ROA and OCF (.412), reflecting their shared relationship with earnings and the use of an identical scaling denominator. Nevertheless, none of the pairwise coefficients approaches a magnitude likely to generate substantial instability in parameter estimation. Accordingly, the regression findings reported in Table 4 can be evaluated without significant concerns regarding multicollinearity.

Table 3: Correlation Matrix of the Study Variables

Variable	1	2	3	4	5	6
1. TBTD	1.000					
2. EQ	−.286**	1.000				
3. SIZE	.174*	.241**	1.000			
4. LEV	.219**	−.198**	.386**	1.000		
5. ROA	−.163*	.327**	.216**	−.274**	1.000	
6. OCF	−.142	.294**	.301**	−.189*	.412**	1.000

Note: Values are simulated, as stated in the original manuscript. The matrix is symmetric, so only the lower triangle is reported here; the original repeated every coefficient above and below the diagonal. The largest off-diagonal correlation is .412, between ROA and OCF.
\ p < .05. \\ p* < .01.

Model 1: Regression Results

The regression estimates presented in Table 4 provide support for H1, with TBTD exhibiting a statistically significant negative coefficient of −0.318 (SE = 0.091, t = −3.495, p = .001). The control variables are likewise statistically significant, and their estimated directions correspond to theoretical expectations. Specifically, ROA (0.421) and OCF (0.187) are positively associated with EQ, while SIZE (0.026) exhibits a comparatively modest positive relationship. Conversely, LEV (−0.074) is negatively associated with EQ. The model accounts for 28.7% of the observed variation in EQ (R^2

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

= .287, adjusted R^2 = .267), with the overall regression achieving statistical significance (F = 14.326, p = .000).

Two additional considerations are important for interpreting these estimates. First, because the reported regression coefficients are unstandardised, their relative magnitudes cannot be directly interpreted as differences in explanatory importance when the predictors are measured on different scales. Although the coefficient for ROA (0.421) exceeds the absolute coefficient for TBTD (−0.318), this comparison partly reflects their respective standard deviations of .058 and .032. A one-standard-deviation increase in TBTD corresponds to an approximate .010 reduction in EQ, compared with an increase of approximately .024 associated with an equivalent standardised movement in ROA. Thus, the disparity between their estimated associations is less pronounced than the unstandardised coefficients initially suggest. Second, the difference between R^2 and adjusted R^2 is relatively small given the inclusion of five predictors, suggesting that the sample is sufficiently large for the adjustment associated with additional model parameters to impose only a limited penalty.

Table 4: Model 1: Ordinary Least Squares Regression of Earnings Quality on Temporary Book-Tax Differences

Predictor	*B*	*SE*	*t*	*p*
Constant	0.412	0.087	4.736	.000
TBTD	−0.318	0.091	−3.495	.001
SIZE	0.026	0.009	2.889	.004
LEV	−0.074	0.028	−2.643	.009
ROA	0.421	0.118	3.568	.000
OCF	0.187	0.071	2.634	.009

Note: B = Unstandardised Regression Coefficient; SE = Standard Error. R^2 = .287, Adjusted R^2 = .267, F = 14.326, p = .000.

Model 2: Structural Paths

The structural estimation results indicate that all three hypothesised pathways achieve statistical significance at $p < .001$, with their estimated directions consistently supporting the proposed relationships. The direct association between TBTD and EQ is negative and statistically significant ($\beta = -0.428$, $t = -7.926$), providing support for H1 within Model 2. Similarly, TBTD exhibits a significant negative relationship with MED ($\beta = -0.365$, $t = -7.604$), consistent with H2. Conversely, the association between MED and EQ is positive and significant ($\beta = 0.512$, $t = 8.393$), supporting H3. Collectively, these findings demonstrate directional consistency across the three structural pathways.

Importantly, the direct path estimate of −0.428 should not be interpreted as directly equivalent to the regression coefficient of −0.318 presented in Table 4, as the two values represent different statistical quantities. Table 4 provides an unstandardised coefficient,

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

whereas Table 5 reports a standardised structural path estimate. Furthermore, the underlying specifications differ in their conditioning variables: Model 1 incorporates four controls, while Model 2 additionally accounts for MED. Consequently, differences between these coefficients do not necessarily indicate contradictory findings. A more appropriate comparison concerns the coefficient estimated under Model 1 and the total effect obtained from Model 2, as examined in Section 5.1.

Table 5: Model 2: Structural Path Coefficients and Direct Effects

Hypothesis	Structural path	β	*SE*	*t*	*p*	Decision
H1	TBTD → EQ	−0.428	0.054	−7.926	< .001	Supported
H2	TBTD → MED	−0.365	0.048	−7.604	< .001	Supported
H3	MED → EQ	0.512	0.061	8.393	< .001	Supported

Note: β = Standardised Path Coefficient; TBTD = Temporary Book-Tax Differences; MED = Mediating Variable; EQ = Earnings Quality

Mediation

The mediation estimates presented in Table 6 identify a negative indirect association between TBTD and EQ operating through MED (β = −0.187). The corresponding bootstrap standard error is 0.032, while the bias-corrected and accelerated 95% confidence interval [−0.254, −0.126] lies entirely below zero, providing evidence of a statistically significant indirect effect. This result is corroborated by the Sobel test ($z = -5.844$, $p < .001$). Since the direct relationship remains statistically significant after accounting for the mediated pathway, the estimated structure indicates partial rather than complete mediation. The magnitude of the indirect effect is consistent with the product of the two constituent structural coefficients, with −0.365 × 0.512 yielding approximately −0.187. Moreover, the direct and indirect effects are both negative, indicating complementary mediation, whereby the two pathways reinforce rather than offset one another. Had their directions differed, the resulting configuration would instead have suggested a suppression mechanism requiring an alternative interpretation.

Beyond statistical significance, the relative magnitudes of the coefficients in Table 5 provide further insight into the estimated structural relationships. Because all three coefficients are standardised and derived from the same structural system, their absolute magnitudes permit direct comparison. The MED → EQ pathway exhibits the largest coefficient (0.512), exceeding both the direct TBTD → EQ relationship (−0.428) and the TBTD → MED pathway (−0.365). If MED were adequately defined and operationalised, this ordering would suggest that the organisational attribute it represents has a stronger association with EQ than TBTD itself, while part of the relationship between TBTD and EQ operates through deterioration in that attribute. The precision of these estimates also warrants consideration. The coefficient-to-standard-error ratios are 7.93 for the direct pathway, compared with 7.60 and 8.39 for the

Vol: 18 No: 2 Year: 2026 ISSN: 2146-0744 (Online) (pp. 221-246) Doi: 10.34109/ijebeg.2026180209

remaining relationships, providing additional information about their relative estimation precision.

Table 6: Mediation Analysis: Indirect Effect of Temporary Book-Tax Differences on Earnings Quality

Path	β	Boot *SE*	95% BCa CI	Sobel *z*	Mediation type
TBTD → MED → EQ	−0.187	0.032	[−0.254, −0.126]	−5.844	Partial Mediation

Note: β = Standardised Indirect Effect; BCa = bias-corrected and accelerated confidence interval based on 5,000 bootstrap resamples. The Sobel test is significant at $p < .001$.

Decomposition, Fit and Explanatory Power

The effect decomposition presented in Table 7 indicates an overall negative relationship between TBTD and EQ, with a total effect of −0.615 comprising a direct effect of −0.428 and an indirect effect of −0.187. The mediated pathway accounts for 30.41% of the total effect, indicating that approximately one-third of the estimated association operates through MED, while slightly more than two-thirds remains attributable to the direct pathway.

Table 7: Decomposition of Direct, Indirect and Total Effects

Cause	Effect	Direct	Indirect	Total	VAF
TBTD	MED	−0.365	—	−0.365	—
MED	EQ	0.512	—	0.512	—
TBTD	EQ	−0.428	−0.187	−0.615	30.41%

Note: VAF = Variance Accounted for, computed as the indirect effect divided by the total effect.

The model evaluation results summarised in Table 8 indicate that all reported fit statistics satisfy their respective conventional acceptability criteria. The normed chi-square value of 1.842 remains below the recommended threshold of 3.00, while the comparative fit index (0.976) and Tucker–Lewis index (0.968) both exceed the benchmark of 0.95. Similarly, the root mean square error of approximation (0.041) falls below the suggested maximum of 0.06, and the standardised root mean square residual (0.035) is comfortably within the threshold of 0.08. Regarding explanatory capacity, the structural model accounts for 54.2% of the variation in EQ and 38.1% of the variation in MED. Figure 2 illustrates the estimated relationship and is reproduced from the original figure at publication resolution.

Table 8: Model 2: Fit Indices and Explanatory Power

Index	Threshold	Model Value	Evaluation
Normed Chi-Square (χ^2/df)	< 3.00	1.842	Excellent Fit
Comparative Fit Index (CFI)	> 0.95	0.976	Good Fit
Tucker–Lewis Index (TLI)	> 0.95	0.968	Good Fit

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

Root Mean Square Error of Approximation (RMSEA)	< 0.06	0.041	Good Fit
Standardised Root Mean Square Residual (SRMR)	< 0.08	0.035	Good Fit
R^2 (Earnings Quality)	—	0.542	Substantial (54.2% Explained)
R^2 (Mediator)	—	0.381	Moderate (38.1% Explained)

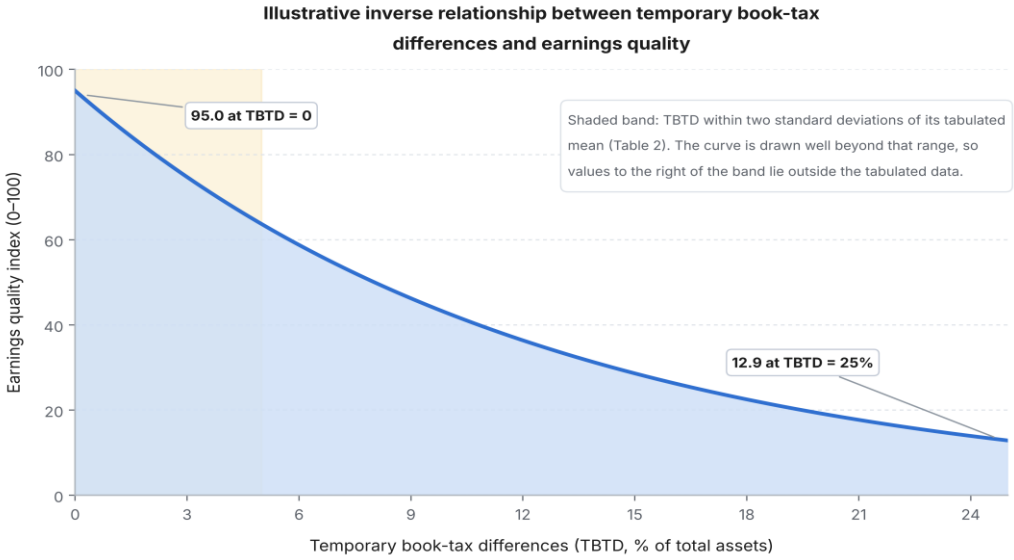

Figure 2: Illustrative Inverse Relationship Between Temporary Book-Tax Differences and Earnings Quality
Note: The curve is an illustration of the hypothesised functional form, not a fitted line through observations; the original manuscript labelled it as simulated and it is reproduced unchanged in shape, range and end points.

Both models yield a consistent negative direction, with no contradiction between their statistically tested findings. Their principal distinction concerns the extent to which the estimated relationship changes under alternative specifications, making model structure a central consideration in interpreting the results.

WHAT THE TWO MODELS SAY ABOUT EACH OTHER

The distinction between the two specifications lies primarily in how they allocate the association between TBTD and EQ. Whereas Model 1 represents the relationship entirely through a direct coefficient, Model 2 partitions the total effect into a mediated component of 30.41% and a remaining direct component of 69.59%. Consequently, the single-equation model captures the expected direction but does not represent the full structural relationship. Excluding an intervening variable does not eliminate its contribution; instead, the association operating through that variable becomes

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

incorporated into the coefficients of the retained pathways. Thus, Table 4, considered independently, suggests an unmediated relationship between TBTD and EQ, whereas the decomposition in Table 7 indicates that this interpretation arises from the restrictions imposed by the original specification. The difference in explanatory capacity must be interpreted with similar caution. Model 1 explains 28.7% of the variation in EQ, compared with 54.2% under Model 2. Although this represents a substantial increase, it does not independently establish that the structural specification is superior. The models employ different estimation principles, and Model 2 introduces an additional endogenous variable for which the system explains 38.1% of the variance. Accordingly, the higher explanatory power reflects the inclusion of the mediated pathway rather than providing conclusive evidence of greater model adequacy.

Interpreting the Direct Effect

One interpretation of the negative relationship is grounded in accrual discretion. Differences between accounting income and taxable income may partly reflect the recognition of earnings before the corresponding amounts become taxable, with such recognised income exhibiting limited persistence. This interpretation accords with evidence linking temporary differences to EQ among listed manufacturing firms (Widiatmoko et al., 2023), as well as findings concerning the continued importance of tax-related differences in explaining earnings persistence (Pereira et al., 2023). Nevertheless, the estimated direction is not uniquely attributable to discretionary reporting behaviour. Similar negative associations may emerge from underlying operating developments without involving managerial discretion. Evidence concerning the moderating influence of declining sales illustrates this alternative explanation (Anderson & Rahiminejad, 2025), while the timing of impairment recognition provides a corresponding accounting mechanism (Tselinko, 2023). Distinguishing reporting discretion from operationally induced differences therefore requires explicit consideration of the circumstances responsible for their emergence. Because neither specification incorporates these conditions, the findings establish the presence and direction of the association without identifying its underlying source.

Interpreting the Mediated Pathway

Although the mediated relationship constitutes the more substantively important result, it also presents the greatest interpretative uncertainty. If MED were explicitly identified, the estimated mediated proportion of 30.41% would suggest that approximately one-third of the overall association operates through an organisational condition rather than exclusively through TBTD. Such an interpretation would imply that the informational usefulness of deferred tax disclosures depends partly on the governance environment in which financial statements are prepared. This possibility is consistent with research associating internal control effectiveness and internal audit quality with financial reporting outcomes (Dorcus Kalembe, 2024; Mounia Boulhaga, 2023). However, the

Vol: 18 **No:** 2 **Year:** 2026 **ISSN:** 2146-0744 (Online) (**pp.** 221-246) **Doi:** 10.34109/ijebeg.2026180209

present evidence does not permit that substantive conclusion. MED is neither conceptually defined nor operationally specified within the study. Although the original discussion invokes governance and transparency mechanisms, these references indicate the intended theoretical domain without establishing the actual measurement construct. Because the interpretation of an indirect effect necessarily depends on the identity and validity of the intervening variable, the reported 30.41% cannot be attributed specifically to governance. It must instead be understood as a characteristic of the estimated structural system.

Fit Indices and What They Establish

Although every fit statistic in Table 8 satisfies its conventional benchmark, these results warrant a more restricted interpretation than the original claim of structural integrity. Such indices evaluate the correspondence between a hypothesised covariance structure and the observed covariance matrix. Their diagnostic usefulness is particularly relevant to latent-variable models employing multiple measurement indicators, whereas their interpretative contribution is more limited when constructs are represented by individual observed ratios, as occurs throughout Table 2. This distinction is central to the methodological differences between covariance-based and variance-based structural estimation (Dash & Paul, 2021). Consequently, favourable fit statistics indicate compatibility between the specified model and its input covariance matrix, but they neither validate the assumed direction of influence nor establish causal relationships. The investigation employed two alternative specifications to examine the relationship between TBTD and EQ in industrial companies. Both produced negative estimates consistent with H1, while the structural model additionally supported H2 and H3. Within that specification, 30.41% of the estimated total effect was attributed to the mediated pathway.

CONCLUSIONS

Across both analytical specifications, TBTD exhibits a statistically significant negative association with EQ. The single-equation regression produces a coefficient of −0.318 ($p = .001$), while the structural model estimates a standardised direct effect of −0.428 ($p < .001$). The latter specification further identifies a negative indirect effect of −0.187, supported by a bootstrap confidence interval of [−0.254, −0.126]. Together, the direct and indirect components yield a total effect of −0.615, distributed between a mediated share of 30.41% and a direct share of 69.59%. These findings indicate that the single-equation approach is structurally incomplete rather than directionally incorrect. Although it identifies the negative association, its direct coefficient incorporates the relationship otherwise represented through MED. This distinction helps explain why the two specifications produce different coefficient magnitudes and levels of explanatory power.

Vol: 18 No: 2 Year: 2026 ISSN: 2146-0744 (Online) (pp. 221-246) Doi: 10.34109/ijebeg.2026180209

RECOMMENDATIONS

For Analysts and Investors: Deferred tax disclosures should be evaluated in conjunction with the economic events underlying the recognised differences. A substantial TBTD arising during declining sales or asset impairments may convey implications different from an equivalent difference reported under stable operating conditions.

For Auditors: Repeatedly substantial TBTDs should inform audit risk assessment without automatically being interpreted as evidence of misreporting. Particular scrutiny should instead be directed towards the recognition judgements responsible for generating those differences.

For Regulators and Standard Setters: Disclosure requirements should emphasise the underlying sources of material TBTDs rather than their aggregate balances alone. The usefulness of deferred tax information depends substantially on users' ability to identify the circumstances producing its individual components.

For Researchers: Future specifications should explicitly identify and estimate potential intervening mechanisms instead of presuming that the relationship operates entirely through a direct pathway. The mediated proportion of 30.41% illustrates the potential importance of this modelling decision.

IMPLICATIONS

From a theoretical perspective, the findings position TBTD within the agency framework as a partially externally verifiable indicator of accrual discretion. They further demonstrate that modelling its relationship with EQ exclusively through a direct association leaves a measurable mediated component unrepresented. From a practical standpoint, deferred tax disclosures provide potentially useful information when interpreted alongside the economic circumstances affecting the reporting period and the governance environment within which the financial statements are prepared.

LIMITATIONS AND FUTURE RESEARCH

The conclusions are subject to four principal limitations. First, the numerical results originate from simulated data intended to illustrate methodological behaviour rather than support population-level inference. Empirical validation therefore requires a clearly identified sample, jurisdiction, reporting period and data source, none of which is specified in the present design. Second, MED remains unnamed and lacks an operational definition, restricting the mediation findings to the estimated statistical system rather than an identifiable theoretical construct. Third, the fit statistics presented in Table 8 concern variables measured through single observed ratios, limiting their

diagnostic interpretation (Dash & Paul, 2021). Fourth, the cross-sectional research design cannot verify the assumed causal sequence between the variables (Leszczensky & Wolbring, 2022). These limitations establish several priorities for subsequent investigation. Future studies should first define, operationalise and validate MED before reassessing the indirect pathway. They should also distinguish alternative sources of TBTD by incorporating the operating and reporting circumstances responsible for its recognition. Employing alternative EQ proxies would help determine whether the observed association depends specifically on earnings persistence. Finally, replication across jurisdictions with differing degrees of book-tax conformity would clarify how the alignment between accounting and taxable income influences the informational significance of the resulting differences.

REFERENCES

Agnus Baby, M. A. M., Anwar Allah Pitchay (2024). A systematic review of financial performance in the manufacturing industry. *Future Business Journal*, *10*(1), 1–20. https://doi.org/10.1186/s43093-024-00353-1

Allen, E. (2025). The information content of the deferred tax valuation allowance: Evidence from venture-capital-backed IPO firms. *Journal of Risk and Financial Management*, *18*(7), 384. https://doi.org/10.3390/jrfm18070384

Anderson, M., & Rahiminejad, S. (2025). Book–tax differences and earnings persistence: The moderating role of sales decline. Article 389. *Journal of Risk and Financial Management*, *18*, 7. https://doi.org/10.3390/jrfm18070389

Anna Görlitz, M. D. (2023). Financial accounting for deferred taxes: A systematic review of empirical evidence. *Management Review Quarterly*, *73*(1), 113–165. https://doi.org/10.1007/s11301-021-00233-w

Audrey Hsu, S. L. (2023). The effect of book-tax conformity on the information environment: From the analyst perspective. *Review of Quantitative Finance and Accounting*, *61*(2), 535–565. https://doi.org/10.1007/s11156-023-01160-5

Ball, R., & Nikolaev, V. V. (2022). On earnings and cash flows as predictors of future cash flows. Article 101430. *Journal of Accounting and Economics*, *73*(1). https://doi.org/10.1016/j.jacceco.2021.101430

Belen Blanco, S. D., Ferdinand A. Gul. (2023). Financial statement comparability and accounting fraud. *Journal of Business Finance & Accounting*, *50*(7-8), 1166–1205. https://doi.org/10.1111/jbfa.12652

Chaudhary, D. V. V. D. P. (2024). Do audit attributes impact earnings quality? Evidence from India. . *Asian Journal of Accounting Research*, *9*(1), 25–34. https://doi.org/10.1108/AJAR-12-2022-0428

Dash, G., & Paul, J. (2021). CB-SEM vs PLS-SEM methods for research in social sciences and technology forecasting. *Technological Forecasting and Social Change*, *173*. https://doi.org/10.1016/j.techfore.2021.121092

Dorcus Kalembe, S. K. N., Twaha Kigongo Kaawaase, Isaac Newton Kayongo. (2024). The relationship between internal audit function quality and earnings quality: The moderating effect of CEO power. *Cogent Business & Management*, *11*(1). https://doi.org/10.1080/23311975.2024.2311159

Dyreng, S. D., Hanlon, M., & Maydew, E. L. (2019). When does tax avoidance result in tax uncertainty? *The Accounting Review*, *94*(2), 179–203. https://doi.org/10.2308/accr-52198

Dyussembina, S., & Park, K. (2024). Book-tax differences, dividend payout, and firm value. . *International Review of Financial Analysis*, *91*, Article 103037. https://doi.org/10.1016/j.irfa.2023.103037

Feng, C., Ye, Y., & Bai, C. (2023). Tax enforcement and corporate financial irregularities: Evidence from China. *International Review of Financial Analysis*, *88*. https://doi.org/10.1016/j.irfa.2023.102697

Floropoulos, S., Tsipouridou, M., & Spathis, C. (2024). Book-tax conformity and earnings management: A research agenda. *Journal of International Accounting, Auditing and Taxation*, *54*. https://doi.org/10.1016/j.intaccaudtax.2024.100603

Ibrahim, N. A., Salehi, M., Al-Refiay, H. A. N., & Dashtbayaz, M. L. (2024). A financial stability model for Iraqi companies. *Risks*, *12*(9), 140. https://doi.org/10.3390/risks12090140

Ines Kateb, I. B. (2024). Navigating governance and accounting reforms in Saudi Arabia's emerging market: Impact of audit quality, board characteristics, and IFRS adoption on financial performance. *International Journal of Disclosure and Governance*, *21*(2), 290–312. https://doi.org/10.1057/s41310-023-00193-5

Jacob, M. (2022). Real effects of corporate taxation: A review. *European Accounting Review*, *31*(1), 269-296. https://doi.org/10.1080/09638180.2021.1934055

Jude Edeigba, E. G. V. K. T. (2023). Analyses of unintended consequences of IAS 12 on deferred income taxes. *China Accounting and Finance Review*, *25*(4), 465–487. https://doi.org/10.1108/CAFR-08-2022-0098

Kalnins, A., & Praitis Hill, K. (2025). The VIF score. What is it good for? Absolutely nothing. *Organizational research methods*, *28*(1), 58-75. https://doi.org/10.1177/10944281231216381

Kovermann, J., & Velte, P. (2019). The impact of corporate governance on corporate tax avoidance: A literature review. *Journal of International Accounting, Auditing and Taxation*, *36*. https://doi.org/10.1016/j.intaccaudtax.2019.100270

Leszczensky, L., & Wolbring, T. (2022). How to deal with reverse causality using panel data? Recommendations for researchers based on a simulation study. *Sociological Methods & Research*, *51*(2), 837–865. https://doi.org/10.1177/0049124119882473

Mounia Boulhaga, H. E., Moataz Elmassri. (2023). The effect of internal control and corporate social responsibility on conditional accounting conservatism: Evidence from France. *Journal of Corporate Accounting & Finance*, *34*(2), 228–241. https://doi.org/10.1002/jcaf.22605

Oh, H. I., & Penman, S. (2024). The accruals–cash flow relation and the evaluation of accrual accounting. *Abacus*, *60*(1), 23-48. https://doi.org/10.1111/abac.12307

Pereira, Â., Pereira, C., Gomes, L., & Lima, A. (2023). Do taxes still affect earning persistence? *Administrative Sciences*, *13*(2). https://doi.org/10.3390/admsci13020048

Rompotis, G. G. (2024). The impact of taxation on firm performance and risk: Evidence from Greece. *Quantitative Finance and Economics*, *8*(1), 29–51. https://doi.org/10.3934/QFE.2024002

Saragih, A. H., Ali, S., Suwardi, E., & Utomo, H. (2024). Finding the missing pieces to an optimal corporate tax savings: Information technology governance and internal information quality. *International Journal of Accounting Information Systems*, *52*. https://doi.org/10.1016/j.accinf.2023.100665

Simon Helms, R. K., Till B. Scheider (2025). Tax system characteristics and country-level differences in earnings management. *Journal of Business Economics*, *95*, 1107–1140. https://doi.org/10.1007/s11573-025-01239-6

Seher, H. O., Al-Yasar, A. R. A., & Bachi, A. N. (2025). The effect of big data analytics capability and budgeting & forecasting quality on construction supply chain management performance and construction firm value. International Journal of Construction Supply Chain Management, 15(2), 109–126. https://www.ijcscm.com/menu-script/index.php/ijcscm/article/view/358

Theodore E. Christensen, A. H., Melissa F. Lewis-Western, Rachel Scott. (2021). Accruals earnings management proxies: Prudent business decisions or earnings manipulation? . *Journal of Business Finance & Accounting*, *49*(3-4), 536–587. https://doi.org/10.1111/jbfa.12585

Tselinko, P. M. D. O. I. (2023). The right time for a big bath: Asset impairment recognition in earnings management. . *Central European Management Journal*, *31*(2), 189–206. https://doi.org/10.1108/CEMJ-12-2021-0156

Viana, D. B. C., Lourenço, I. M. E. C., & Paulo, E. (2023). The effect of IFRS adoption on accrual-based and real earnings management: Emerging markets' perspective. . *Journal of Accounting in Emerging Economies*, *13*(3), 485–508. https://doi.org/10.1108/JAEE-05-2021-0172

Widiatmoko, J., Indarti, M. G. K., & Ifada, L. M. (2023). How temporary book tax differences influence earning quality? An integrated analysis with investment opportunity set and human capital. . *JIA (Jurnal Ilmiah Akuntansi)*, *8*(1), 225–244. https://doi.org/10.23887/jia.v8i1.60842